



**REPORT OF THE AUDITOR OF PUBLIC ACCOUNTS
AUDIT OF THE CABINET FOR HEALTH SERVICES**

**Made as Part of the Statewide Single Audit
of the Commonwealth of Kentucky**

For the Year Ended June 30, 2001

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EXECUTIVE SUMMARY

Report of the Auditor of Public Accounts Audit of the Cabinet for Health Services For the Year Ended June 30, 2001

BACKGROUND: The Single Audit Act of 1984, subsequent amendments, and corresponding regulations, require the auditing of financial statements and the compliance and internal controls applicable to federal moneys received by the Commonwealth. To comply with these requirements, we audited internal controls and compliance at both the central and agency level. This summary is on our audit of one (1) organizational unit of the Commonwealth, the Cabinet for Health Services.

The Cabinet for Health Services is the state government agency that administers programs to promote mental and physical health for Kentucky's citizens. The Cabinet seeks to provide quality healthcare and related services, as well as seeking to expand eligibility and control rising health care costs, for eligible persons for programs administered by the Cabinet.

EXPENDITURES: The Cabinet for Health Services expended federal awards totaling \$2,642,852,126 in the following manner:

- \$2,630,602,310 in cash from nine (9) federal grantors
- \$12,249,816 in non-cash grants (i.e., vaccines)

SUMMARY OF AUDITOR'S RESULTS:

Financial Statement Accounts

Compliance: No instances of noncompliance

Internal Control Over Financial Reporting: Six (6) reportable conditions and two (2) other matter comments.

Federal Awards and Schedule of Expenditures of Federal Awards

Compliance: No instances of noncompliance.

Internal Control Over Compliance: Four (4) reportable conditions, none of which are material weaknesses, and one (1) other matter comment.

Financial Statement Reportable Conditions

- Information Technology
- Cash Receipts

Financial Statement Other Matter Comments

- Cash Receipts
- Medical Assistance Program

Federal Programs with Reportable Conditions

- Substance Abuse Block Grant
- Medical Assistance Program

Federal Programs with Other Matter Comments

- Medical Assistance Program

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INTRODUCTION

**CABINET FOR HEALTH SERVICES
INTRODUCTION
FOR THE YEAR ENDED JUNE 30, 2001**

Introduction

The Auditor of Public Accounts (APA), acting as principal auditor in conjunction with various certified public accounting firms, annually performs a statewide single audit of the Commonwealth of Kentucky. This audit allows the Commonwealth to comply with federal audit requirements as set forth in the Single Audit Act of 1984, as amended by Public Law 104-156, and the regulations contained in the U.S. Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

Schedule of Expenditures of Federal Awards

The Schedule of Expenditures of Federal Awards is organized by federal grantor for the Cabinet of Health Services (CHS). The Catalog of Federal Domestic Assistance (CFDA) numbers and program names are listed under the federal grantor administering the program. The Notes to the Schedule of Expenditures of Federal Awards provide more detailed information on certain aspects of the expenditures, such as the amount given to subrecipients.

Since not all state agencies use the Management Administrative Reporting System (MARS) Subsystems for Projects, the APA requested CHS to prepare worksheets of federal financial assistance, both cash and noncash. The source of these worksheets included MARS, agency accounting systems, agency manual records, etc. CHS was also asked to reconcile the worksheets to MARS and to federal grantor reports. These worksheets were compiled into the accompanying Schedule of Expenditures of Federal Awards.

Schedule of Findings and Questioned Costs

The Schedule of Findings and Questioned Costs consists of three (3) sections:

- Summary of Auditor's Results,
- Financial Statement Findings, and
- Federal Award Findings and Questioned Costs.

The audit finding number and classification (as reportable, material, or other matter) are provided as part of the audit opinion summary. Major programs audited are listed on the Summary of Auditor's Results. The Financial Statement Findings list the audit findings related to the financial statements (required to be reported in accordance with *Government Auditing Standards*). The Federal Award Findings and Questioned Costs lists all findings related to federal awards. Generally, the state agency, CFDA number and program, federal agency, pass-through agency, and the compliance area to which the finding relates are presented. In both reports, reportable conditions and reportable instances of noncompliance are presented first, then material weaknesses and material instances of noncompliances, followed by other matters.

**CABINET FOR HEALTH SERVICES
INTRODUCTION
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

Summary Schedule of Prior Audit Findings

Audit findings reported in the Schedule of Findings and Questioned Costs for the fiscal year ended June 30, 2000, as well as any previous finding which have not been resolved, are reported in CHS' Summary Schedule of Prior Audit Findings for the fiscal year ended June 30, 2001. If the APA determines the agency's Summary Schedule of Prior Audit Findings materially misrepresents the status of any prior audit finding, a new audit finding is issued and reported in the Schedule of Findings and Questioned Costs.

The Summary Schedule of Prior Audit Findings is organized based on whether the prior year finding was reportable, material, or other matters. The findings of each classification are categorized as (1) fully corrected, (2) not corrected or partially corrected, (3) corrective action taken differs significantly from corrective action previously reported, or (4) finding no longer valid or does not warrant further action.

Audit Approach

Our audit was conducted in accordance with the Single Audit Act Amendments of 1996, OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, *Government Auditing Standards* (also referred to as the Yellow Book), and auditing standards generally accepted in the United States of America. The scope of the statewide single audit for the year ended June 30, 2001 included:

- An audit of the general-purpose financial statements and required supplementary schedules in accordance with auditing standards generally accepted in the United States of America;
- An audit of the supplementary Schedule of Expenditures of Federal Awards in accordance with auditing standards generally accepted in the United States of America;
- An audit of the internal control applicable to CHS to the extent necessary to consider and test the internal accounting and administrative control systems as required; and
- A selection and testing of transactions and records relating to each major federal financial assistance program to obtain reasonable assurance that CHS administers its major federal programs in compliance with laws and regulations for which noncompliance could have a material effect on the allowability of program expenditures or on the general-purpose financial statements of the Commonwealth.

The APA conducted the audit of internal control, focusing on the following objectives:

- Considering the internal control in order to determine auditing procedures on the general-purpose financial statements of the Commonwealth.
- Determining if CHS has internal controls to provide reasonable assurance that it is managing the federal assistance programs in compliance with applicable laws and regulations.

**CABINET FOR HEALTH SERVICES
INTRODUCTION
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

List of Abbreviations/Acronyms Used in This Report

APA	Auditor of Public Accounts
CDP	Custom Data Processing
CFDA	Catalog of Federal Domestic Assistance
CHS	Cabinet for Health Services
CMHC	Community Mental Health Center
CMS	Center for Medicare/Medicaid Services
Commonwealth	Commonwealth of Kentucky
DEC	Digital Equipment Corporation (now part of Compaq)
DMS	Department of Medicaid Services
DPH	Department for Public Health
DRP	Dispute Resolution Program
DSI	Department of Social Insurance
FAC	Finance and Administration Cabinet
FEP	Front End Processor
FMRB	Financial Management and Reporting Branch
FY	Fiscal Year
HCFA	Health Care Financing Administration
IT	Information Technology
KRS	Kentucky Revised Statutes
MAP	Medicaid Assistance Program
MARS	Management Administrative and Reporting System
MHMR	Mental Health Mental Retardation
NA	Not Applicable
OAG	Office of Attorney General
OMB	Office of Management and Budget
PC	Personal Computer
PDS	Prevention Data Set
PRO	Peer Review Organization
RCW	Record of Control Weakness
RFP	Request for Proposals
RPC	Regional Prevention Center
SAPT	Substance Abuse Prevention and Treatment
SFY	State Fiscal Year
SMI	Supplementary Medical Insurance
VAX	Virtual Address Extension (a DEC VAX is a line of mid-range computers)
VSIS	Vital Statistics Information System
WIC	Special Supplemental Nutrition Program for Women, Infants, and Children

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SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

**CABINET FOR HEALTH SERVICES
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FEDERAL ASSISTANCE PROGRAMS
FOR THE YEAR ENDED JUNE 30, 2001**

CABINET FOR HEALTH SERVICES

U.S. Department of Agriculture

Direct Programs:

10.557	Special Supplemental Nutrition Program for Women, Infants, and Children (Note 2) (Note 9)	\$	81,331,341
10.570	Nutrition Program for the Elderly (Commodities) (Note 9)		1,722,933

Passed Through From Cabinet for Families and Children:

10.561	State Administrative Matching Grants for Food Stamp Program (Note 2)		174,966
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U.S. Department of Justice

Passed Through From Justice Cabinet - Office of the Secretary:

16.579	Byrne Formula Grant Program		1,477
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U.S. Department of Labor

Direct Program:

17.235	Senior Community Service Employment Program (Note 9)		1,601,861
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Passed Through From Cabinet for Families and Children:

17.253	Welfare-to-Work Grants to States and Localities		246
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U.S. Environmental Protection Agency

Direct Programs:

66.032	State Indoor Radon Grants (Note 9)		261,458
66.606	Surveys, Studies, Investigations and Special Purpose Grants (Note 9)		106,632
66.707	TSCA Title IV State Lead Grants - Certification of Lead-Based Paint Professionals (Note 9)		366,734

U.S. Department of Energy

Passed Through From Cabinet for Families and Children:

81.042	Weatherization Assistance for Low-Income Persons		31,364
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Passed Through From Natural Resources and Environmental Protection Cabinet:

81.502	Paducah Gaseous Diffusion Plant Environmental Monitoring and Oversight (Note 9)		414,049
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U.S. Federal Emergency Management Agency

Passed Through From Department of Military Affairs:

83.549	Chemical Stockpile Emergency Preparedness Program (Note 9)		141,689
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See accompanying Notes to the Schedule of Expenditures of Federal Awards

**CABINET FOR HEALTH SERVICES
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FEDERAL ASSISTANCE PROGRAMS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

CABINET FOR HEALTH SERVICES (CONTINUED)

U.S. Department of Education

Direct Programs:

84.181	Special Education - Grants for Infants and Families with Disabilities (Note 9)	\$	4,412,478
84.186	Safe and Drug-Free Schools and Communities - State Grants (Note 9)		1,927,634
84.323	Special Education - State Program Improvement Grants for Children with Disabilities (Note 9)		186,768

U.S. Department of Health and Human Services

Direct Programs:

93.041	Special Programs for the Aging - Title VII, Chapter 3 - Programs for Prevention of Elder Abuse, Neglect, and Exploitation (Note 9)		65,702
93.042	Special Programs for the Aging - Title VII, Chapter 2 - Long Term Care Ombudsman Services for Older Individuals (Note 9)		123,712
93.043	Special Programs for the Aging - Title III, Part F - Disease Prevention and Health Promotion Services (Note 9)		201,017
93.044	Special Programs for the Aging - Title III, Part B - Grants for Supportive Services and Senior Centers (Note 9)		4,888,856
93.045	Special Programs for the Aging - Title III, Part C - Nutrition Services (Note 9)		7,308,172
93.046	Special Programs for the Aging - Title III, Part D - In-Home Services for Frail Older Individuals (Note 9)		12,988
93.048	Special Programs for the Aging - Title IV - Training, Research and Discretionary Projects and Programs (Note 9)		15,563
93.052	Nation Family Caregiver Support Program		69,043
93.110	Maternal and Child Health Federal Consolidated Programs (Note 9)		177,996
93.116	Project Grants and Cooperative Agreements for Tuberculosis Control Programs (Note 9) (Note 13)	1,020,062	\$ 82,418
93.119	Grants for Technical Assistance Activities Related to the Block Grant for Community Mental Health Services - Technical Assistance Centers for Evaluation		45,863
93.130	Primary Care Services - Resource Coordination and Development - Primary Care Offices (Note 9)		71,147
93.136	Injury Prevention and Control Research and State and Community Based Programs (Note 9)		396,989
93.150	Projects for Assistance in Transition from Homelessness (PATH) (Note 9)		300,000
93.217	Family Planning - Services (Note 9)		4,200,021
93.230	Consolidated Knowledge Development and Application (KD&A) Program (Note 9)		4,755,648

**CABINET FOR HEALTH SERVICES
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FEDERAL ASSISTANCE PROGRAMS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

CABINET FOR HEALTH SERVICES (CONTINUED)

Passed Through From Cabinet for Families and Children:

93.556	Promoting Safe and Stable Families	14
93.558	Temporary Assistance for Needy Families (Note 2)	499,251
93.563	Child Support Enforcement (Note 2)	15,747
93.568	Low-Income Home Energy Assistance (Note 2)	8,072
93.569	Community Services Block Grant	15,762
93.595	Welfare Reform Research, Evaluations and National Studies	3,507,172
93.658	Foster Care - Title IV-E (Note 2)	223,032
93.667	Social Services Block Grant (Note 2) (Note 9)	1,101,072
93.671	Family Violence Prevention and Services/Grants for Battered Women's Shelters - Grants to States and Indian Tribes	2,776
NA	Clinical Laboratory Improvement Act	169,430

U.S. Corporation for National and Community Service

Direct Program:

94.011	Foster Grandparent Program (Note 9)	\$	539,878
Total Cabinet for Health Services		\$	2,630,602,310
		\$	12,249,816

**CABINET FOR HEALTH SERVICES
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FEDERAL ASSISTANCE PROGRAMS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

CABINET FOR HEALTH SERVICES (CONTINUED)

U.S. Department of Health and Human Services (Continued)

Direct Programs (Continued):

93.234	Traumatic Brain Injury - State Demonstration Grant Program (Note 9)	\$	10,316	
93.235	Abstinence Education (Note 9)		498,535	
93.238	Cooperative Agreements for State Treatment Outcomes and Performance Pilot Studies Enhancement (Note 9)		498,817	
93.241	State Rural Hospital Flexibility Program		170,000	
93.262	Occupational Safety and Health Research Grants (Note 9)		97,820	
93.268	Immunization Grants (Note 9) (Note 13)		2,102,185	\$ 11,577,662
93.283	Centers for Disease Control and Prevention - Investigations and Technical Assistance (Note 9)		1,556,167	
93.630	Developmental Disabilities Basic Support and Advocacy Grants (Note 9)		750,078	
93.767	State Children's Insurance Program (Note 2)		18,113,940	
93.777	State Survey and Certification of Health Care Providers and Suppliers (Note 2)		6,007,091	
93.778	Medical Assistance Program (Note 2) (Note 9)		2,433,931,616	
93.779	Health Care Financing Research, Demonstrations and Evaluations (Note 9)		353,927	
93.917	HIV Care Formula Grants (Note 9)		4,423,838	
93.919	Cooperative Agreements for State-Based Comprehensive Breast and Cervical Cancer Early Detection Programs (Note 9) (Note 13)		2,084,771	25,000
93.931	Demonstration Grants to States for Community Scholarship (Note 9)		25,638	
93.940	HIV Prevention Activities - Health Department Based (Note 9) (Note 13)		1,465,924	63,362
93.944	Human Immunodeficiency Virus (HIV)/Acquired Immunodeficiency Virus Syndrome (AIDS) Surveillance (Note 9)		119,045	
93.945	Assistance Programs for Chronic Disease Prevention and Control (Note 9)		410,019	
93.958	Block Grants for Community Mental Health Services (Note 9)		5,195,576	
93.959	Block Grants for Prevention and Treatment of Substance Abuse (Note 2) (Note 9)		18,507,101	
93.977	Preventive Health Services - Sexually Transmitted Diseases Control Grants (Note 9) (Note 13)		709,064	501,374
93.988	Cooperative Agreements for State-Based Diabetes Control Programs and Evaluation of Surveillance Systems (Note 9)		350,330	
93.991	Preventive Health and Health Services Block Grant (Note 9)		2,445,528	
93.994	Maternal and Child Health Services Block Grant to the States (Note 9)		8,358,369	

CABINET FOR HEALTH SERVICES
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2001

Note 1 - Purpose of the Schedule and Significant Accounting Policies

Purpose of the Schedule - OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, requires a Schedule of Expenditures of Federal Awards showing each federal financial assistance program as identified in the *Catalog of Federal Domestic Assistance*.

Basis of Presentation - The accompanying Schedule of Expenditures of Federal Awards is presented in accordance with OMB Circular A-133. As defined in the Circular, federal financial assistance “. . . means assistance that non-federal entities receive or administer in the form of grants, loans, loan guarantees, property (including donated surplus property), cooperative agreements, interest subsidies, insurance, food commodities, direct appropriations, and other assistance, but does not include amounts received as reimbursement for services rendered to individuals . . .” It includes awards received directly from federal agencies, or indirectly through other units of state and local governments. Accordingly, the accompanying schedule includes both cash and noncash federal financial assistance programs. Those programs that have not been assigned a catalog number, or for which the catalog number was not available, have been shown either at the bottom of the relevant federal grantor subheading or under the “Other Federal Assistance” subheading.

Reporting Entity - The accompanying schedule includes all federal financial assistance programs administered by CHS. CHS is an organizational unit of the Commonwealth of Kentucky as defined by KRS 12.010 and is included in the Commonwealth entity for financial reporting purposes.

Basis of Accounting - The cash expenditures on the accompanying schedule are presented primarily on the basis of cash disbursements as modified by the application of KRS 45.229. Consequently, certain expenditures are recorded in the accounts only when cash is disbursed.

KRS 45.229 provides that the Finance and Administration Cabinet may, “. . . for a period of thirty days after the close of any fiscal year, draw warrants against the available balances of appropriations made for that fiscal year, for the payment of expenditures incurred during that year or in fulfillment of contracts properly made during the year, but for no other purpose.” However, there is an exception to the application of KRS 45.229 in that regular payroll expenses incurred during the last pay period of the fiscal year are charged to the next year.

**CABINET FOR HEALTH SERVICES
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

Note 1 - Purpose of the Schedule and Significant Accounting Policies (Continued)

Basis of Accounting (Continued)

The general-purpose financial statements of the Commonwealth are presented on the modified accrual or accrual basis of accounting depending on fund type. Therefore, the Schedule of Expenditures of Federal Awards may not be directly traceable to the general-purpose financial statements in all cases.

The noncash expenditures presented on this schedule represent the noncash assistance expended by CHS during the period July 1, 2000 through June 30, 2001, using the method or basis of valuation as described in the notes to the Schedule of Expenditures of Federal Awards for each program. These noncash assistance programs are not reported in the general-purpose financial statements for the year ended June 30, 2001.

Inter-agency Activity -Certain transactions relating to federal financial assistance may appear in the records of more than one state agency. To avoid the overstatement of federal expenditures, the following policies were adopted for the presentation of CHS' schedule:

- (a) Federal moneys may be received by one state agency (primary state agency - recipient) and passed through to another state agency (secondary state agency - subrecipient) where the moneys are expended. Except for pass-throughs to state universities as discussed below, this inter-agency transfer activity is reported in the schedule as follows:
- Under the primary state agency, the federal program is reported as a direct program. However, the transfer of money to the secondary state agency is not included in the primary state agency's expenditures.
 - Under the secondary state agency, the federal program is reported as a pass-through program. The expenditure of the transferred moneys is reported in the secondary agency's expenditures.

Because the CHS' schedule excludes federal financial assistance related to state universities, when a state agency passes federal money to a state university, this is reported in the schedule as an expenditure of that state agency.

- (b) Federal moneys received by CHS and used to purchase goods or services from another state agency are reported in the schedule as an expenditure.

CABINET FOR HEALTH SERVICES
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)

Note 2 - Type A Programs

Under the provisions of OMB Circular A-133, a Type A program for the Commonwealth means any program for which total expenditures of federal awards exceed \$15 million for FY 01. Clusters are a group of closely related programs sharing common compliance requirements. A cluster of programs shall be considered as one program for determining Type A programs. In relation to noncash federal financial assistance programs, this threshold is generally applied to the amount of assistance expended during the year as presented on the noncash portion of the Schedule of Expenditures of Federal Awards, plus any cash expenditures under the same CFDA designation.

The CHS had four cash major programs that met the Type A major program definition for the year ended June 30, 2001. CHS identified one cluster, Medicaid, which included more than one federal program, among the Type A programs. These Type A programs were:

CFDA #	Program Title	Expenditures
10.557	Special Supplemental Nutrition Program for Women, Infants, and Children	\$ 81,331,341
93.767	State Children's Insurance Program	18,113,940
93.959	Block Grants for Prevention and Treatment of Substance Abuse	18,507,101
Medicaid Cluster		
93.777	State Survey and Certification of Health Care Providers and Suppliers	6,007,091
93.778	Medical Assistance Program	2,433,931,616
	Total Type A Programs	<u><u>\$ 2,557,891,089</u></u>

CABINET FOR HEALTH SERVICES
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)

Note 3 - Subrecipient Activity

A subrecipient is a non-federal entity that expends federal awards received from a pass-through entity to carry out a federal program. The following list summarizes the amount of federal funds sent to subrecipients.

CFDA #	Federal Program Name	Amount Sent
10.557	Special Supplemental Nutrition Program for Women, Infants, and Children	\$ 13,826,952
10.570	Nutrition Program for the Elderly (Commodities)	1,722,933
17.235	Senior Community Service Employment Program	1,546,132
66.032	State Indoor Radon Grants	209,288
66.606	Surveys, Studies, Investigations and Special Purpose Grants	106,632
66.707	TSCA Title IV State Lead Grants – Certification of Lead-Based Paint Professionals	73,516
81.502	Paducah Gaseous Diffusion Plant Environmental Monitoring And Oversight	249,692
83.549	Chemical Stockpile Emergency Preparedness Program	90,779
84.181	Special Education Grants for Infants and Families with Disabilities	2,056,602
84.186	Safe and Drug-Free Schools and Communities – State Grants	1,657,294
84.323	Special Education – State Program Improvement Grants for Children with Disabilities	106,116
93.041	Special Programs for the Aging – Title VII, Chapter 3 – Programs for Prevention of Elder Abuse, Neglect, and Exploitation	65,702
93.042	Special Programs for the Aging – Title VII, Chapter 2 – Long Term Care Ombudsman Services for Older Individuals	39,065
93.043	Special Programs for the Aging – Title III, Part F – Disease Prevention and Health Promotion Services	201,017
93.044	Special Programs for the Aging – Title III, Part B – Grants for Supportive Services and Senior Centers	4,657,300
93.045	Special Programs for the Aging – Title III, Part C – Nutrition Services	6,949,634
93.046	Special Programs for the Aging – Title III, Part D – In-Home Services for Frail Older Individuals	12,988

CABINET FOR HEALTH SERVICES
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)

Note 3 - Subrecipient Activity (Continued)

CFDA #	Federal Program Name	Amount Sent
93.048	Special Programs for the Aging – Title IV – Training, Research and Discretionary Projects and Programs	\$ 15,563
93.110	Maternal and Child Health Federal Consolidated Programs	87,585
93.116	Project Grants and Cooperative Agreements for Tuberculosis Control Programs	828,362
93.130	Primary Care Services-Resource Coordination and Development-Primary Care Offices	52,248
93.136	Injury Prevention and Control Research and State and Community Based Programs	306,689
93.150	Projects for Assistance in Transition from Homelessness (PATH)	300,000
93.217	Family Planning-Services	4,187,803
93.230	Consolidated Knowledge Development and Application (KD&A) Program	4,274,656
93.234	Traumatic Brain Injury-State Demonstration Grant Program	10,316
93.235	Abstinence Education	462,411
93.238	Cooperative Agreements for State Treatment Outcomes and Performance Pilot Studies Enhancement	473,278
93.262	Occupational Safety and Health Research Grants	97,820
93.268	Immunization Grants	1,275,751
93.283	Centers for Disease Control and Prevention-Investigations and Technical Assistance	1,334,232
93.630	Developmental Disabilities Basic Support and Advocacy Grants	434,808
93.667	Social Services Block Grant	16,466
93.778	Medical Assistance Program	2,680,891
93.779	Health Care Financing Research, Demonstrations, and Evaluations	274,244
93.917	HIV Care Formula Grants	4,329,759
93.919	Cooperative Agreement for State-Based Comprehensive Breast and Cervical Cancer Early Detection Programs	1,852,219
93.931	Demonstration Grants to States for Community Scholarships	8,652
93.940	HIV Prevention Activities-Health Department Based	1,054,099

**CABINET FOR HEALTH SERVICES
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

Note 3 - Subrecipient Activity (Continued)

CFDA #	Federal Program Name	Amount Sent
93.944	Human Immunodeficiency Virus (HIV)/Acquired Immunodeficiency Virus Syndrome (AIDS) Surveillance	\$ 42,811
93.945	Assistance Programs for Chronic Disease Prevention and Control	145,382
93.958	Block Grants for Community Mental Health Services	5,191,300
93.959	Block Grants for Prevention and Treatment of Substance Abuse	18,099,416
93.977	Preventive Health Services-Sexually Transmitted Diseases Control Grants	159,221
93.988	Cooperative Agreements for State-Based Diabetes Control Programs and Evaluation of Surveillance Systems	326,722
93.991	Preventive Health and Health Services Block Grant	2,438,165
93.994	Maternal and Child Health Services Block Grant to the States	8,294,519
94.011	Foster Grandparent Program	122,647
	Total Amounts Sent To Subrecipients	<u>\$92,749,677</u>

CABINET FOR HEALTH SERVICES
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)

Note 4 - Noncash Expenditure Programs

CHS had five (5) noncash programs for the year ended June 30, 2001. These noncash programs and a description of the method/basis of valuation follow:

CFDA #	Program Title	Amount	Method/Basis of Valuation
93.116	Project Grants and Cooperative Agreements for Tuberculosis Control Programs	\$ 82,418	Per authorized award for personnel costs and travel.
93.268	Immunization Grants	11,577,662	Per authorized award for personnel, vaccine costs, and travel.
93.919	Cooperative Agreements for State-Based Comprehensive Breast and Cervical Cancer Early Detection Programs	25,000	Per authorized personnel costs.
93.940	HIV Prevention Activities – Health Department Based	63,362	Per authorized personnel costs.
93.977	Preventive Health Services – Sexually Transmitted Diseases Control Grants	501,374	Per authorized personnel costs and travel.
	Total	<u>\$12,249,816</u>	

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REPORTS ON COMPLIANCE AND ON INTERNAL CONTROL



EDWARD B. HATCHETT, JR.
AUDITOR OF PUBLIC ACCOUNTS

Report on Compliance and on Internal Control Over
Financial Reporting Based on an Audit of the General-Purpose Financial
Statements Performed in Accordance With *Government Auditing Standards*

To the People of Kentucky
Honorable Paul E. Patton, Governor
Marcia Morgan, Secretary
Cabinet for Health Services

As part of the audit of the general-purpose financial statements of the Commonwealth of Kentucky as of and for the year ended June 30, 2001, we have audited receipts, expenditures, payroll, accounts receivable, accounts payable, and judgments and contingencies of the Cabinet for Health Services (CHS), an organizational unit of the Commonwealth as defined by KRS 12.010, and have issued our report thereon dated December 21, 2001. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Commonwealth's financial statements are free of material misstatement, we performed tests of CHS' compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Report on Compliance and on Internal Control Over
Financial Reporting Based on an Audit of the General-Purpose
Financial Statements Performed in Accordance With *Government Auditing Standards*
(Continued)

Internal Control Over Financial Reporting

In planning and performing our audit, we considered CHS' internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect CHS' ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying schedule of findings and questioned costs as items 01-CHS-01, 01-CHS-02, 01-CHS-03, 01-CHS-04, 01-CHS-05, and 01-CHS-06.

A material weakness is a condition in which the design or operation of one (1) or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions described above are material weaknesses. We also noted other matters involving the internal control over financial reporting, which are included in this report in the schedule of findings and questioned costs as items 01-CHS-7, and 01-CHS-8.

This report is intended solely for the information and use of management and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Respectfully submitted,



Edward B. Hatchett, Jr.
Auditor of Public Accounts

December 21, 2001



EDWARD B. HATCHETT, JR.
AUDITOR OF PUBLIC ACCOUNTS

Report on Compliance With Requirements Applicable to Each
Major Program and on Internal Control Over Compliance in Accordance
With OMB Circular A-133 and on the Schedule of Expenditures of Federal Awards

To the People of Kentucky
Honorable Paul E. Patton, Governor
Marcia Morgan, Secretary
Cabinet for Health Services

Compliance

As part of the Statewide Single Audit of the Commonwealth of Kentucky, we have audited the compliance of the Cabinet for Health Services (CHS), an organizational unit of the Commonwealth of Kentucky as defined by KRS 12.010, with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2001. CHS' major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of CHS' management. Our responsibility is to express an opinion on CHS' compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about CHS' compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on CHS' compliance with those requirements.

In our opinion, CHS complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2001.

Report on Compliance With Requirements Applicable to Each
Major Program and on Internal Control Over Compliance in Accordance
With OMB Circular A-133 and on the Schedule of Expenditures of Federal Awards
(Continued)

Internal Control Over Compliance

The management of CHS is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered CHS' internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect CHS' ability to administer a major federal program in accordance with applicable requirements of laws, regulations, contracts, and grants. Reportable conditions are described in the accompanying schedule of findings and questioned costs as items 01-CHS-9, 01-CHS-10, 01-CHS-11, and 01-CHS-12.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with the applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions described above is a material weakness. We also noted other matters involving the internal control over compliance, which we have reported in the accompanying schedule of findings and questioned costs as item 01-CHS-13.

Schedule of Expenditures of Federal Awards

We have audited the general-purpose financial statements of the Commonwealth as of and for the year ended June 30, 2001, and have issued our report thereon dated December 21, 2001. Our audit was performed for the purpose of forming an opinion on the general-purpose financial statements taken as a whole. The accompanying schedule of expenditures of federal awards of CHS is presented for the analysis as required by OMB Circular A-133 and is not a required part of the general-purpose financial statements. Such information has been subjected to the auditing procedures applied in the audit of the general-purpose financial statements taken as a whole.

Report on Compliance With Requirements Applicable to Each
Major Program and on Internal Control Over Compliance in Accordance
With OMB Circular A-133 and on the Schedule of Expenditures of Federal Awards
(Continued)

Schedule of Expenditures of Federal Awards (Continued)

The general-purpose financial statements of the Commonwealth are prepared on an accrual/modified accrual basis of accounting. However, the schedule of expenditures of federal awards of the Cabinet for Health Services is prepared on the basis of cash disbursements as modified by the application of KRS 45.229. Consequently, certain expenditures are recorded in the accounts only when cash is disbursed. Accordingly, the schedule of expenditures of federal awards is not intended to present the expenditures of federal awards in conformity with accounting principles generally accepted in the United States of America.

In our opinion, except for the effect of the application of a different basis of accounting as explained above, the schedule of expenditures of federal awards of CHS is fairly stated, in all material respects, in relation to the Commonwealth's general-purpose financial statements taken as a whole.

This report is intended solely for the information and use of management and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Respectfully submitted,



Edward B. Hatchett, Jr.
Auditor of Public Accounts

Schedule of Expenditures of Federal Awards -
December 21, 2001
April 30, 2002

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

**CABINET FOR HEALTH SERVICES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001**

SECTION 1 - SUMMARY OF AUDITOR'S RESULTS

Financial Statement Accounts

Financial Statement Accounts: We issued an unqualified opinion on the Commonwealth's general-purpose financial statements, which included CHS as of and for the year ended June 30, 2001.

Internal Control Over Financial Reporting: Our consideration of CHS' internal control over financial reporting disclosed six (6) reportable conditions. In addition, we noted two (2) other matters involving internal control over financial reporting as reported in Section 2 of the Schedule of Findings and Questioned Costs.

Compliance: In relation to the audit of CHS' accounts that we audited, and the schedule of expenditures of federal awards, the results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Federal Awards and Schedule of Expenditures of Federal Awards

Compliance: We issued an unqualified opinion on CHS' compliance with the requirements applicable to each of its major federal programs.

Internal Control Over Compliance: Our consideration of CHS' internal control over compliance disclosed four (4) reportable conditions. We believe that none of the reportable conditions noted are material weaknesses.

Additionally, our audit disclosed one (1) comment that we consider an other matter comment that relates to internal control over major programs. We have reported this in Section 3 of the Schedule of Findings and Questioned Costs.

Schedule of Expenditures of Federal Awards: We issued a qualified opinion on CHS' Schedule of Expenditures of Federal Awards because the schedule was presented on a basis of accounting that was not in conformance with accounting principles generally accepted in the United States of America as described in Note 1 of the schedule. The opinion was issued in relation to the Commonwealth's general-purpose financial statements taken as a whole.

**CABINET FOR HEALTH SERVICES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 1 – SUMMARY OF AUDITOR’S RESULTS

Identification of Major Programs Audited

OMB Circular A-133 defines a major program as “a Federal program determined by the auditor to be a major program in accordance with section_.520 or a program identified as a major program by the Federal awarding agency or pass-through entity in accordance with section_.215(c).” Section_.520 states, “[t]he auditor shall use a risk-based approach to determine which Federal programs are major programs.” The following is a list of major Type A programs audited:

CFDA #	Program Title	Expenditures
10.557	Special Supplemental Nutrition Program For Women, Infants, And Children	\$ 81,331,341
93.767	State Children’s Insurance Program	18,113,940
93.959	Block Grants For The Prevention And Treatment Of Substance Abuse	18,507,101
Medicaid Cluster		
93.777	State Survey And Certification Of Health Care Providers And Suppliers	6,007,091
93.778	Medical Assistance Program	2,433,931,616
Total Type A Programs		<u>\$ 2,557,891,089</u>

In addition, the following Type B programs were audited as major programs:

93.268	Immunization Grants	\$ 13,679,847
93.994	Maternal and Child Health Services Block Grant to the States	13,223,264
Total Type B Programs Audited		<u>\$ 26,903,111</u>
Total Major Programs Audited		<u>\$ 2,584,794,200</u>

**CABINET FOR HEALTH SERVICES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 1 – SUMMARY OF AUDITOR’S RESULTS

Dollar Threshold Used to Distinguish Between Type A and Type B Programs

The maximum dollar threshold used to distinguish between Type A and Type B Programs was \$15,000,000.

Auditee Risk

The Commonwealth did not qualify as a low-risk auditee.

SECTION 2 - FINANCIAL STATEMENT FINDINGS

***Reportable Conditions Relating to Internal Controls and/or Reportable
Instances of Noncompliance:***

**FINDING 01-CHS-1: Custom Data Processing, Inc. Should Improve Controls For
Cabinet For Health Services Data**

Review of controls established by Custom Data Processing, Inc. (CDP) to provide reasonable assurance that logical access to the Cabinet for Health Services (CHS) related programs and data is limited to properly authorized individuals revealed that the controls were not suitably designed based on the following findings:

- Application servers are logged in under a shared administrator account. While the servers are locked with a screen saver password, several employees, including programmers, know the screen saver password.
- Text logs are extracted from system logs generated from the application servers. Operations management and personnel review the text logs daily. Users may modify the text logs with administrator level access on the application servers.
- CDP's two internet connections (one in Frankfort, Kentucky and one in La Grange, Illinois) are using proxy software as the only method to protect CDP resources from internet attacks. CDP also has a publicly accessible web server that allows web users to directly connect to the CDP internal network.
- The Windows NT Security Account Manager, a file that contains all user accounts and password information, is not encrypted.
- Management could not confirm that the Front End Processor (FEP) user account file, that contains all user accounts and password information, is encrypted. In addition, management could not confirm that the transmission of clear text FEP user passwords over the network.

**CABINET FOR HEALTH SERVICES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 2 - FINANCIAL STATEMENT FINDINGS

FINDING 01-CHS-1: Custom Data Processing, Inc. Should Improve Controls For Cabinet For Health Services Data (Continued)

Recommendation

CDP should improve procedures to prevent unauthorized or undetected access to information resources.

Management's Response and Corrective Action Plan

- *The current system design requires the application servers to be logged into under a shared administrator account. To continue to provide the level of service contracted with CHS, certain programmers must know the password to access these systems in the event a fatal flaw or bug is encountered during the nightly update. CDP will explore other alternatives for running the application programs and where possible will implement additional levels of security. We will also attempt to further limit programmers' access to these servers.*
- *CDP will investigate and where possible implement additional levels of security that will assure that unauthorized changing of the text log files cannot occur. Until this is implemented, CDP will begin a process whereby the Operations staff runs a program to print out the text logfile and the operator will attest to its status and content at that point in time.*
- *CDP has installed a Sonic Wall firewall on its Internet connections*
- *CDP will investigate encrypting this file.*
- *CDP will investigate how to encrypt these passwords as they traverse the network.*

FINDING 01-CHS-2: The Department For Public Health Should Complete A Formal Information System Security Policy

As noted during the previous four (4) audits, the Department for Public Health (DPH) did not provide adequate security for the Local Health Network that governs the Women, Infants, and Children (WIC) System. The following weaknesses were reported last year and remain unresolved for FY 01:

- Initial Request for Access: There was no formal system access request policy in place.
- CDP Reports: No violation or attempted unauthorized system access reports were received from CDP for review.

**CABINET FOR HEALTH SERVICES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 2 - FINANCIAL STATEMENT FINDINGS

FINDING 01-CHS-2: The Department For Public Health Should Complete A Formal Information System Security Policy (Continued)

Our examination revealed that the DPH still does not have a formal access request policy in place. The security administrator refers to a letter issued to users dated September 17, 1999 detailing the access procedures currently in place as policy. However, this has not been incorporated into the formal security policy. Failure to document existing policies could lead to a lack of understanding by management and users, and result in noncompliance with security policy for areas such as the issuing, deleting, and/or sharing of user IDs.

Additionally, we tested a sample of 42 CHS user requests for mainframe access and found that 17, or 41%, were missing one (1) or more required authorizing signatures. Further, we tested 11 access requests for WIC access and found that eight (8) of those users did not have request forms on file. Discussions revealed a review was done in January 2000 of user requests with access to WIC. The WIC security administrator at CHS had reviewed the access levels provided to WIC users and had made several adjustments for certain users, and had even deleted the access for some IDs. However, it was found that those users who had obtained access and signed the Local Health Network Security Request Form prior to January 2000 do not have request forms on file. It appears these forms may have been discarded.

Finally, our examination also revealed that DPH does not receive any violation or attempted unauthorized system access reports from CDP, and it does not have established formal procedures to contend with unauthorized network intrusions.

The appropriateness of user access to systems cannot be ensured without a properly approved system access request. Documentation should be available to verify proper authorization of the system access granted. Further, users that are granted the minimum access necessary to complete their jobs indicate a strong security environment. Finally, uniform application of formal and documented security policies and procedures provides continuity for policy implementation as well as sets the tone of management concern for a strong system to secure assets and resources. These policies and procedures provide a security framework to educate management and users of their responsibilities. Failure to comply with security policies could lead to interruption of processing or other services, unauthorized data or program modification, and destruction of assets.

**CABINET FOR HEALTH SERVICES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 2 - FINANCIAL STATEMENT FINDINGS

FINDING 01-CHS-2: The Department For Public Health Should Complete A Formal Information System Security Policy (Continued)

Recommendation

We recommend the following additional steps be taken by DPH to strengthen security for the Local Health Network:

- Initial Request for Access: (a). Develop detailed written policies to establish standards for system security. Also, develop procedures to be followed by the security administrator and system users including procedures for requesting system access. (b). All users with access to WIC that do not have signed and approved Local Health Network Security Request Forms on file should be requested to complete an updated form.
- CDP Reports: Establish formal procedures for contending with unauthorized intrusions to the WIC network. These procedures should include steps for requesting reports from CDP containing unauthorized system access attempts.

Management's Response and Corrective Action Plan

The following comments are provided in response to computer security:

There are several different components to DPH computer security. We have provided the auditors with relevant memos to demonstrate activity with regard to computer security. We do agree that all processes and procedures need to be brought together in one document. We have hired an information technology (IT) person to write an IT Operations Guide. This guide will bring those components together. A copy will be provided to your office when completed. Estimated completion date is April 30, 2002.

The WIC Program uses the department's security access process. Procedures are attached. There are additional layers to the Local Health Network but the front door access is secured through the department's password assignment process. (A diagram was provided to the auditors) The Administrative Policy and Procedures Manual for Local Health Departments (pages 2 and 3) of the Patient and Community Health Services Reporting and Billing Procedures Section addresses security clearance and assigning passwords for local health departments. Additionally, we were provided with a list of WIC Program staff that supposedly did not have proper access to the WIC system. There were seven such people on the WIC Program staff. All of these employees were cited as not having proper access in the prior audit. The authorization was signed on January 21, 2000, by the Administrative Section Supervisor of the Food Delivery/Data Section.

**CABINET FOR HEALTH SERVICES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 2 - FINANCIAL STATEMENT FINDINGS

FINDING 01-CHS-2: The Department For Public Health Should Complete A Formal Information System Security Policy (Continued)

Management's Response and Corrective Action Plan (Continued)

The portion of your audit relating to mainframe security is not a DPH responsibility. This responsibility resides in the Office of Program Support, Technology Resources Management Branch of our Cabinet. A copy of the RCW [Record of Control Weakness] was forwarded to their work group.

It is my understanding that CDP does have formal procedures for detecting and dealing with unauthorized intrusions. We agree that a coordinated, documented procedure of notification to DPH is needed and will be accomplished. A copy will be provided when completed. Estimated completion date is April 30, 2002.

FINDING 01-CHS-3: The Financial Management And Reporting Branch Should Limit Access to Deposits

Receipts from various divisions within CHS, including the Vital Statistics Branch, are delivered to the Financial Management and Reporting Branch (FMRB) daily. Upon delivery all checks are stamped with a transmittal number for tracking purposes. The cash is recounted, and monies are secured in the safe. All receipts that FMRB processes are put into the same deposit bag within the safe. This process occurs many times throughout the day.

FMRB has six (6) people with access to the safe. All six (6) people also could potentially have access to the deposit bag. Access to the safe is neither limited nor recorded.

The Vital Statistics Branch deposit is usually the only one containing cash. It is the first deposit processed each day. Throughout the day, up to six (6) people place deposits into the same deposit bag, which has the cash. Thus, the potential for loss or theft is greatly increased if there are not any controls over access to the safe and deposits.

Recommendation

We recommend that the Vital Statistics Branch deposit be secured in a different deposit bag than other agency receipts.

Management's Response and Corrective Action Plan

The Financial Management and Reporting Branch within the Cabinet for Health Services has reviewed this record of control weakness and the recommendation. As of October 24, 2001 the use of a separate deposit bag for Vital Statistics deposits has been implemented.

**CABINET FOR HEALTH SERVICES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 2 - FINANCIAL STATEMENT FINDINGS

FINDING 01-CHS-4: The Vital Statistics Branch Should Improve Security Over Assets And Segregate Job Duties

The Vital Statistics Branch issues birth, death, marriage, and divorce certificates. They collect receipts by walk-in, mail, and phone requests. Due to two (2) cases of fraud last year, the APA decided to give closer attention to the Vital Statistics Branch. We visited the agency on three (3) separate occasions and noticed the following control weaknesses:

- 1) As we noted in a previous audit, the auditor observed the prior day receipts being taken out of the safe for deposit preparation. Once the deposit was prepared, the entire deposit was left unattended long enough for someone to take the receipts.
- 2) Requested certificates are printed on watermarked documents. Some of these certificates are pre-numbered and some are not. The branch does not have a document custodian who has the exact count of blank certificates on hand. There is no logbook of any kind showing the certificates used, voided, or missing.
- 3) Openings in the front and rear of the office are accessible to anyone in the building.
- 4) Current practices for receipts are not adequate to achieve proper control over them. Receipts are not issued to walk-ins who pay fees in cash. Checks received by mail are not restrictively endorsed at the earliest possible point. Receipts are not reconciled to a receipts logbook after posted, by batch or by the day. One (1) flextime employee stays 15 minutes longer than the other employees. During this time, all unopened correspondence is left in the unlocked file cabinet and this employee is responsible for locking the cabinet.
- 5) The branch issues death certificates to funeral homes by way of prepaid vouchers. The vouchers are easily counterfeited. The person who receives the prepaid money and posts it, also controls the issuance of the voucher.
- 6) Each morning the safe is unlocked for distribution of non-processed requests, deposit preparation, and whatever cash is left from the previous day. In addition, a clerk is issued a key to a cabinet containing signed blank checks. The safe is left unlocked and unattended all day with an average of \$15,000 receipts inside.
- 7) The key issued from the safe unlocks a cabinet located in the front of the office, and is unlocked each morning by the clerk. The cabinet is left unlocked until the end of the day. The cabinet contains a stack of signed blank checks, which is easily accessible by anyone who walks by the cabinet.
- 8) Data Entry Operators have assigned user IDs and passwords. The passwords have not been changed in over two (2) years, and on some occasions, more than one (1) operator shares user IDs. Three (3) people have a complete list of the user IDs and passwords.

**CABINET FOR HEALTH SERVICES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 2 - FINANCIAL STATEMENT FINDINGS

FINDING 01-CHS-4: The Vital Statistics Branch Should Improve Security Over Assets And Segregate Job Duties (Continued)

Recommendation

We recommend the following:

- 1) The Vital Statistics Branch should provide better physical security over receipts.
- 2) The branch should use only pre-numbered certificates and assign someone to keep track of the pre-numbered certificates.
- 3) Install a door at each entrance, and these two doors should lock as they are shut. Only branch personnel should have access to this area.
- 4) (a) The branch should lock all funds in a secure location before the employees leave each day. The flextime employees should not have access to the receipts when no one else is present. (b) Restrictively endorse checks when the mail is opened or received at the front desk. Once endorsed, all checks and cash should be recorded in a receipts logbook for mailed in receipts or by entering the transaction in the cash register. (c) When receiving cash from walk-ins, a pre-numbered cash receipt (manual or numbered cash register receipt) should be issued. The cash register tape or the manual cash receipts should be batched and reconciled to the cash register reconciliation sheet. The money deposited each day should be reconciled back to the operator cash reconciliation sheets and to the cash receipts issued logbook or equivalent record.
- 5) The branch should print prepaid vouchers on a security type of pre-numbered paper. The branch should assign one employee to be in charge of receiving the prepaid money, and segregate the duty of issuing the vouchers to another employee.
- 6) The safe should be locked when not in use.
- 7) The signed blank checks should be accounted for two (2) or three (3) times a week and locked in the safe during the day.
- 8) (a) Passwords should be changed immediately. This process should continue on a regular basis every 30 to 90 days. Operators should choose their own password. Two (2) operators should not ever share user IDs and passwords. Passwords should be kept confidential. (b) Vital Statistics Branch should have the Accountant III perform either the end of day reconciliation or the deposit preparation, but not perform both tasks.

**CABINET FOR HEALTH SERVICES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 2 - FINANCIAL STATEMENT FINDINGS

FINDING 01-CHS-4: The Vital Statistics Branch Should Improve Security Over Assets And Segregate Duties (Continued)

Management's Response and Corrective Action Plan

CHS provided the corresponding responses:

- 1) Effective October 20, 2001, when the accountant responsible for preparing the daily deposit leaves the desk (for any reason) while preparing the deposit, the deposit receipts will be locked, by the employee, in the desk until employee returns.*
- 2) All on-line security paper currently is pre-numbered. This paper is used to print certified copies of all birth certificates from 1961 to present (after being key punched). The long form security paper, used for all death, marriage, divorce, births prior to 1961, and new births prior to being keyed, is not pre-numbered. On the next reorder of this paper, we will request to have it pre-numbered for tracking purposes and will track the same as we track the on-line paper.*

In August 2001, the Administrative Section Supervisor of the Certification Section was assigned to track the use of security paper in the Vital Statistics Office on first floor of the Human Resources Building. The paper, in its original sealed, numbered boxes, is kept in a locked room in the Vital Statistics Vault area in the basement of the building. The supervisor of the Vault Unit is responsible for the security of the paper while in his unit. The Section Supervisor calls down for security paper when it is needed for printers and copiers on the first floor. The requested number of sealed boxes is sent up from the vault where the supervisor logs the date, box numbers and beginning numbers ending numbers of the on-line paper. The supervisor will issue on-line paper to the 4 printers and record beginning and ending numbers. At the end of each day the unused on-line paper returned to the supervisor will be logged into the logbook also by numbers. The number of "VOID" certificates will be logged and subtracted from the number of certificates printed along with the unused paper. This can also be done with the long form paper after receiving the new order, which will be pre-numbered for tracking purposes. Effective November 1, 2001, the Vault Supervisor will also log the date, number of boxes, the box number and the numbers on the on-line paper when it is sent up to the first floor.

**CABINET FOR HEALTH SERVICES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 2 - FINANCIAL STATEMENT FINDINGS

FINDING 01-CHS-4: The Vital Statistics Branch Should Improve Security Over Assets And Segregate Duties (Continued)

Management's Response and Corrective Action Plan (Continued)

"Void" stamps are being purchased and upon receipt, every certified copy of a certificate printed and not of sufficient quality to be issued to a customer will be stamped "VOID" and will be handed over to supervisors several times a day for tracking. At the end of every week after being logged on a daily basis these voided certificates will be shredded. Presently, "VOID" is being written on the printed certificate when it is inadequate for issuance to the customer.

Personnel in the Office of the Secretary, Cabinet for Health Services has contacted several other state Vital Statistics offices concerning procedures for tracking security paper. All these will be taken into consideration.

As of October 1, 2001, all employees work between the hours of 8:00 AM and 4:30 PM.

The office is investigating the possibility of adding counters to Lexmark Printers so actual number of on-line birth certificates printed can be counted each day, this will add another security feature to the auditing of on-line security paper. The copy machines have counters but will not suffice as a tracking method. Security paper is used in one tray and regular paper is used in a second tray. This is necessary for the printing of death certificates since verifications of a death certificate are printed on pink paper as the certified copies are printed on security paper, The vendor has been contacted, there is no way just to count the paper going through a single tray.

- 3) The Human Resource Building is owned by the Commonwealth of Kentucky and managed by Facilities Management within the Finance and Administration Cabinet. The Cabinet for Health Services is a tenant in the building. Structural changes are made at the discretion of the Finance and Administration Cabinet. This building was designed for flexibility in that stationary walls do not divide offices. Offices are established with mobile wall panels. Also there are multiple agencies housed within the complex. Within the past year, security of the entire building has been enhanced significantly with the requirement of an ID badge that is read through a card reader at employee entrances.*

**CABINET FOR HEALTH SERVICES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
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SECTION 2 - FINANCIAL STATEMENT FINDINGS

FINDING 01-CHS-4: The Vital Statistics Branch Should Improve Security Over Assets And Segregate Duties (Continued)

Management's Response and Corrective Action Plan (Continued)

The Vital Statistics office has installed ropes, with signs attached stating "RESTRICTED AREA" across all open entrances into the office. Staff have been instructed to monitor the area for any unauthorized entry. The Cabinet is also looking into the feasibility of video security for the Vital Statistics Office. Effective October 18, 2001 the outgoing mail trays were moved from near the rear exit of the office to a centralized location in the view of the Administrative Section Supervisor of the Certification Section and the Fee Control Unit Supervisor.

- 4) *Effective October 1, 2001, flex time prior to 8:00 AM and after 4:30 PM has been discontinued. All receipts and security paper are locked in the safe between 4:30 PM and 8:00 AM the next morning.*

Within a six-month period of time all mail openers in the Fee Control Unit will be trained to do data entry and all data entry operators will be trained on the procedures of how to open and direct mail to the other units. The procedure will then be for each employee of the Fee Control Unit to open a piece of mail, immediately restrictively endorse the check or money order, date and code the check or money order, date and code the correspondence, and then enter the data on the DEC VAX computer (this is an older computer which is no longer made) for an audit trail prior to opening another piece of mail. This procedure should suffice for an immediate audit trail for each piece of correspondence. Hence the individual daily reports would be reconciled back to the operator who opened the correspondence, endorsed the check, and then entered the data on the VAX. There would be 8 or 9 smaller deposits to reconcile rather than 4 or 5 larger ones, which should also make it easier for the accountant to reconcile daily reports. When the new Vital Statistics Information System (VSIS) is implemented in late 2003, this is basically the way it will work (all mail openers and data entry operators will be 1 in the same) plus an electronic daily log will be automatic. One possible problem may arise if this solution causes the processing of the mail to slow down, if so, other measures will need to be taken. This office is mandated by law to issue certified copies of death certificates within two days if they are requested at the time of the filing of the original certificate with this office. This is already difficult at times with the present process.

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SECTION 2 - FINANCIAL STATEMENT FINDINGS

FINDING 01-CHS-4: The Vital Statistics Branch Should Improve Security Over Assets And Segregate Duties (Continued)

Management's Response and Corrective Action Plan (Continued)

Additional cash registers are being purchased for the Front Desk clerks. We expect to have them in place by January 1, 2002. Each clerk taking in checks and cash will be responsible for only their register. Each register tape will be matched daily to the cash reconciliation sheet. There will make for smaller individual reports batched from the Front Desk, which should be easier to reconcile than one larger one. Smaller reports will also tell us if, and which, employee is having trouble with entering receipts in the cash register. As with the employees in the Fee Control Unit, the procedure will be for each employee who receives an, application and the fee, to immediately restrictively endorse the check or money order, date and code the check or money order, date and code the application and then enter the data on the VAX for an audit trail prior to accepting another application from a customer.

- 5) The State Registrar is in the process of purchasing pre-numbered impede security paper to use for pre-paid vouchers. The security paper is expected to be in place by January 1, 2002. A log is presently being set up on the Fee Control Unit Supervisor's personal computer using Office Excel software. The supervisor will log in dates and voucher numbers distributed to funeral homes and record the used voucher number and date upon receipt back in the Vital Statistics Office. A data entry operator has always had the responsibility of receiving the prepaid money and the Fee Control Unit Supervisor has issued the vouchers to the funeral homes. We will continue to stamp the raised seal that states "Commonwealth of Kentucky Vital Statistics" on each voucher*
- 6) Effective November 1, 2001, the Fee Control Unit safe will be locked at all times, except when it is necessary to remove items from or return items to the safe during work hours.*
- 7) Effective August 27, 2001, the Administrative Section Supervisor of the Certification Section was assigned to ensure blank Vital Chek checks were accounted for properly. All these special purpose blank checks are kept in a locked safe at all times. At the end of each day the supervisor gives each Vital Check operator a check to be printed for that day. The printed checks are then returned to the supervisor to store in the safe until the daily deposit is prepared the following day.*

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SECTION 2 - FINANCIAL STATEMENT FINDINGS

FINDING 01-CHS-4: The Vital Statistics Branch Should Improve Security Over Assets And Segregate Duties (Continued)

Management's Response and Corrective Action Plan (Continued)

- 8) *Effective November 1, 2001, data entry operators will change passwords for the user ID assigned to them on a regular basis, the 1st of every other month (approximately every 60 days). Operators will choose their own passwords and not share with other employees.*

Effective November 16, 2001 the Accountant III will be responsible for the end of day reconciliation and the Accountant I will perform the preparation of the daily deposit. Training will be required for backup personnel.

FINDING 01-CHS-5: The Vital Statistics Branch Should Perform An Accurate Cash Reconciliation

The Vital Statistics Branch issues birth certificates, death certificates, marriage certificates, and divorce certificates for fees ranging from \$6 to \$10. The requests for these documents come into the branch through mail, phone, and walk-in applications. Each operator submits an individual batch report detailing the day's transactions.

On the following day, the branch's Accountant III runs a total batch report and prepares the deposit to be sent to the FMRB. If the deposit does not match the report, the Accountant III must go over the individual batch reports to locate errors. If errors cannot be located and corrected, the department has a petty cash amount kept in the safe made up of state funds for these types of occurrences. State funds are used to correct the deposits. The petty cash has a balance, which is not to exceed \$100. If the petty cash becomes low on state funds, any overages on future dates are taken from the daily deposit and added to the current total. If the petty cash has a branch acceptable amount on hand, when a deposit has any overages, these overages are added into the deposit under the report heading of "Miscellaneous".

We noted several areas where a cash reconciliation sheet was not prepared at closeout. Furthermore, even when a cash reconciliation sheet was prepared the overages and shortages were not accurately reported due to the use of the petty cash amount.

Recommendation

We recommend that no government funds be set aside for petty cash. The amount currently in the petty cash should be deposited immediately. Furthermore, each person handling funds should prepare an accurate cash reconciliation at closeout.

Management's Response and Corrective Action Plan

Vital Statistics has taken steps to assure that deposits received will be deposited as collected, and no overage/underage account will be used.

**CABINET FOR HEALTH SERVICES
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(CONTINUED)**

SECTION 2 - FINANCIAL STATEMENT FINDINGS

FINDING 01-CHS-6: The Vital Statistics Branch Should Take Steps To Prevent Identity Theft

Kentucky birth certificates are easy to obtain from the Vital Statistics Branch (Vital Statistics), and can be used to get a passport and other identification documents. Obtaining a birth certificate is often one of the first steps in perpetrating an identity theft.

Kentucky death certificates are also easy to obtain, and show the deceased's social security number. Having the social security number of a recently deceased person could result in credit cards being issued in the deceased's name. This is an example of identity theft. Two (2) supervisors and two (2) managers at Vital Statistics stated that they recognize this risk and would like to see this matter corrected.

Identity theft could be facilitated by the ease with which vital records, such as birth and death certificates, can be obtained.

Proper internal control dictates that Vital Statistics not release:

- data which is excluded from disclosure by law, and
- data which could easily facilitate identity theft or other crimes.

Most states are more restrictive on providing vital statistics information than Kentucky. Vital Statistics personnel have indicated their desire to meet the national norms in this area.

When KRS 213.011(14) and KRS 213.131(1) are read together, it is clear that vital records should not be open for inspection or publicly released except where specifically authorized by law. KRS 213.131(1) further states "[a]dministrative regulations adopted by the cabinet shall provide for adequate standards of security and confidentiality of vital records . . ." Title 901, Chapter 5 of the Kentucky Administrative Regulations addresses vital statistics, but these regulations do not address adequate standards of security and confidentiality of vital records.

Recommendation

We recommend:

- CHS promulgate administrative regulations as required by KRS 213.131(1) to provide for adequate standards of security and confidentiality of vital records;

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SECTION 2 – FINANCIAL STATEMENT FINDINGS

FINDING 01-CHS-6: The Vital Statistics Branch Should Take Steps To Prevent Identity Theft (Continued)

Recommendation (Continued)

- Appropriate steps be taken to prevent disclosure of vital records data that could be misused by those seeking to commit theft; and
- Legislation be proposed and enacted to strengthen the security of confidential vital records data, similar to the legislation already enacted in most other states.

Management's Response and Corrective Action Plan

*KRS 213.131(1) does state, "To protect the integrity of vital records, to insure their proper use . . . it shall be unlawful . . . to issue a copy," but this section then states "except as authorized by this chapter." KRS 213.136(1) must be followed and this statute states in pertinent part, "The state registrar **shall** upon receipt of an application issue a certified copy of a vital record in the registrar's custody or a part thereof to **any** applicant." Although KRS 61.878(1) (a) excludes public records that would constitute an unwarranted invasion of personal privacy, the Attorney General has issued opinions 81-400 and 82-234 concerning the disclosure of information within vital statistics records. OAG 82-234 states that on a birth certificate only medical information and the mother's home address are considered private information and the name cannot be redacted. OAG 81-400 states "There are no privacy rights involved in a request to inspect death records since the exemption provided by KRS 61.878(1)(a) pertains only to "personal privacy", and that term only applies to the living." Accordingly, in order to possibly avoid the facilitation of identity theft, the statutes noted above would need to be amended to exclude vital records. Presently, only 13 states (including Kentucky) have open birth records and 19 states (including Kentucky) have open death records.*

Auditor's Reply

We believe that the disclosure of social security numbers and other confidential vital records data is contrary to the intent of the Kentucky General Assembly. We strongly encourage CHS to promptly seek passage of legislation clarifying and strengthening the law in this area.

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(CONTINUED)**

SECTION 2 - FINANCIAL STATEMENT FINDINGS

Other Matters Relating to Internal Controls and/or Noncompliance:

FINDING 01-CHS-7: Vital Statistics Should Update Its Computer System

The computer hardware and software in the Vital Statistics Branch is a stand-alone system used for handling receipts and issuing various certificates. This system has been in place since 1983 and is extremely outdated, which increases the risk of operational problems with the programs or a failure of the entire system.

Recommendation

We recommend the Vital Statistics Branch update the computer system that records the Vital Statistics and issues the certificates of those statistics in order to assure that this data is always available in a timely manner. Manual procedures should be documented in the event that the branch would have to return to manual procedures.

Since there appears to be a real risk that the old system may die before it is replaced with a new system, the branch should explore various interim approaches that could be used to improve the workflow and speed up the recovery time. For example, the branch may be able to use personal computers (PCs) and some software with blank forms to capture data, facilitate the workflow, and enable batch loading of data to speed the recovery time.

Management's Response and Corrective Action Plan

The Finance and Administration Cabinet is presently in the process of putting out to vendors a Request for Proposals (RFP) for a new Vital Statistics System (VSIS). The anticipated implementation of the new system is summer of 2003. The VSIS will alleviate many of the Vital Statistics weaknesses noted by the APA auditors. A vendor already under contract with the Governor's Office of Technology has been contacted and has verbally stated that they can get the VAX system operational if it crashes. The Vital Statistics Office produced forms to be used manually as a backup if the VAX crashed during Y2K conversions. The forms are still available in case there is a time when they will be needed.

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(CONTINUED)**

SECTION 2 - FINANCIAL STATEMENT FINDINGS

FINDING 01-CHS-8: Vital Statistics Should Update Its Policies And Procedures Manual

The Vital Statistics Branch has a procedures manual, but the manual is not sufficiently comprehensive to assure that the operations of the branch will be covered by good internal controls. During our audit, we found over ten internal control weaknesses of the operations of the branch. The manual currently in use touches on many of the areas where we found weaknesses; however, the manual does not include the control procedures necessary to account for and protect the receipts and blank forms that are fundamental to the office.

Recommendation

We recommend the Vital Statistics Branch upgrade their procedures manual to cover all of the areas addressed in the audit. The branch could request such manuals from other states in order to assist in the upgrading of their procedures.

Management's Response and Corrective Action Plan

The Vital Statistics procedures manual is continually being updated. Written procedures concerning the areas addressed in this audit will be updated upon implementation of the weakness. Several state Vital Statistics offices have been contacted that use the VAX system and a similar accounting program. These states have implemented new systems due to antiquity of the VAX, therefore many of procedures would not apply to Kentucky until our new Vital Statistics Information System is implemented (expected summer of 2003).

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SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

***Reportable Conditions Relating to Internal Control and/or Reportable
Instances of Noncompliance:***

**FINDING 01-CHS-9: The Drug Rebate Program Should Be More Involved In The
Dispute Resolution Program In Order To Collect More Money**

State Agency: Cabinet for Health Services

Federal Program: CFDA: 93.778 - Medical Assistance Program

Federal Agency: U.S. Department of Health and Human Services

Pass-Through Entity: Not Applicable

Compliance Area: Special Tests and Provisions

Amount of Questioned Costs: None

Our prior year report noted there was an outstanding accounts receivable balance of \$79 million for drug rebates. Part of management's response indicated a \$58 million adjustment for an error made in 1992 leaving an outstanding balance of \$21 million. Two million of the \$21 million outstanding balance was from years prior to 2000. In this year's review, we noted that the total amount outstanding is \$30.3 million. Of the \$30.3 million outstanding, \$22.4 million is over 12 months old. The Commonwealth's share of the \$30.3 million calculates to \$6.2 million, which is significant considering budget constraints the state is facing.

For the current year review we noted the following weaknesses:

1. Only the 1997-1998 portion of the \$22.4 million that is over 12 months old went through the resolution process. This was by contract with a private vendor during the audit period.
2. Participation in the Dispute Resolution Program provided by the Center for Medicare/Medicaid Services (CMS) is not as involved as it should be.

The effects can be described as follows:

1. The backdating function of Medicaid allows justifiable expenses to be charged from an earlier period. Waiting extended periods of time to initiate dispute resolutions has become common practice. This practice reduces the likelihood of collection.

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SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-CHS-9: The Drug Rebate Program Should Be More Involved In The Dispute Resolution Program In Order To Collect More Money (Continued)

2. According to the Term Leader of CMS' Dispute Resolution Program, "KY has only been minimally involved" in the national Dispute Resolution Program meetings and that "would certainly account for any unusually 'high' unpaid/disputed rebate amounts". The Team Leader goes on to say, "those states that are the most active in the DRP [Dispute Resolution Program] are most successful in timely collecting rebates and resolving disputes." Having less of a hands-on approach subjects the state to scrutiny. Collection tactics of private vendors representing other states have been an issue in the past and could have negative impacts.

The National Drug Rebate Program was established within the Medicaid Assistance Program (MAP) by federal law. One purpose of the program is to recover from drug manufacturers a fee per drug unit dispensed by Medicaid service providers. It is the Department of Medicaid Services' (DMS) responsibility to establish internal controls to properly record, collect, and report all amounts owed to and received by MAP.

Recommendation

We recommend:

1. Management should implement procedures to circumvent negative effects of the backdating process so that resolution processes can go forward within a closer time frame.
2. Management should intensify its efforts in resolving disputes by attending and participating in the Dispute Resolution Program meetings. This ultimately should diminish the need to hire a private vendor to assist in this.

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SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-CHS-9: The Drug Rebate Program Should Be More Involved In The Dispute Resolution Program In Order To Collect More Money (Continued)

Management's Response and Corrective Action Plan

1. *Providers have 12 months from the date of service in order to bill for a prescription. Previous contract with private vendor only involved completing drug rebate dispute resolutions for 1997 and 1998 and was completed December 31, 2001. Current contract with private vendor will cover 1999 and 2000 and will also involve disputed claims from 1991 through 1996.*
2. *Due to budget restraints, travel has been limited for employees to attend meetings such as Dispute Resolution Program (DRP). We will be seeking approval for Betsy Scott to attend upcoming DRP conference in Denver, Colorado in June. Our goal is for Ms. Scott, with her strong pharmacy background and Medicaid experience to become an in house expert in this area. Considering the staffing level of this program (one person), it is highly unlikely that a private vendor would be necessary at this time due to the many billing errors that could occur and the number of drugs that are invoiced.*

Auditor's Reply

In nearly all instances, drug rebate dispute resolution could be pursued by the thirteenth month after incurring the charge. The management's response certainly does not offer a good reason why the drug rebate receivable would not be pursued until they are two (2) years of age or more. This approach would appear to reduce the drug rebate receivable outstanding balances.

Participation in the Dispute Resolution Program could result in a high rate of return on a small investment. The federal government provides a 50% administrative match that states can claim for travel expenses related to attending these meetings. This would be a cost justified expenditure, even when budgets are very tight.

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SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-CHS-10: The Cabinet For Health Services Should Reconcile The Supplementary Medical Insurance Data To The Agency Level Unisys Reports

State Agency: Cabinet for Health Services

Federal Program: CFDA: 93.778 - Medical Assistance Program

Federal Agency: U.S. Department of Health and Human Services

Pass-Through Entity: Not Applicable

Compliance Area: Reporting

Amount of Questioned Costs: None

During our review of control procedures related to Supplementary Medical Insurance (SMI), we discovered that agency personnel are not able to properly reconcile CMS agency level reports to Unisys reports.

Agency procedures indicate that on the 25th of each month or, the next business day, a "Third Party Tape", which includes all SMI transactions for that month is sent to HCFA's central office in Baltimore. Three (3) or four (4) days before the 25th of the month, Unisys sends a preliminary report to its staff to be spot-checked. The staff has a couple days to make any necessary corrections. After any corrections are made, the final report is run by Unisys and sent to the Department of Social Insurance (DSI). DSI then sends this report to CMS in Baltimore.

CMS produces a similar report of SMI claims. This report is produced from CMS's own database. Upon receipt of the Unisys Report from Kentucky, a comparison is made of the two (2) reports. However, CMS bills from its report and makes no effort to reconcile any differences between the two (2) reports.

The Unisys reports sent to the CHS do not match the billing notices from CMS. The purpose of this reconciliation of the two (2) reports is to ascertain whether valid claims have been properly processed against agency records and properly recorded through Unisys, third party administrator for Medicaid claims.

This has been an area of concern with the APA during the last three (3) audits. DMS, along with the federal government and Unisys, is attempting to correct this problem.

If agency personnel are not able to reconcile the CMS reports with Unisys reports, errors and material differences could exist and go undetected. Failure to monitor these accounts could jeopardize the program and future funding.

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SCHEDULE OF FINDINGS AND QUESTIONED COSTS
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(CONTINUED)**

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-CHS-10: The Cabinet For Health Services Should Reconcile The Supplementary Medical Insurance Data To The Agency Level Unisys Reports (Continued)

A government entity needs an internal control structure which provides controls to ensure compliance with laws and regulations, safeguards assets, checks the accuracy and reliability of accounting data, and promotes operational efficiency. A good internal control structure is essential for the achievement of full accountability, which is the prime issue in today's government. Reconciliations often are key controls.

Recommendation

We recommend that Medicaid personnel continue to work with the federal government and Unisys to correct these errors. The agency should consider acquiring the "Third Party Tape" from Baltimore. The "Third Party Tape" can be used to create an exception report, and the errors can be located. After these errors are corrected, CHS management should create an appropriate reconciliation before that responsibility is assigned to a clerk.

Management's Response and Corrective Action Plan

The original intent of this report was not to reconcile the SMI dollars.

The Department for Medicaid Services is reviewing the Medicare Buy-In procedures and will be working with Center of Medicare and Medicaid Services (CMS) and Unisys to implement new procedures to ensure the information is reconciled monthly.

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SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-CHS-11: The Division Of Substance Abuse Progress Reports For Subrecipient Monitoring Should Be Submitted In A Timely Manner

State Agency: Cabinet for Health Services

Federal Program: CFDA 93.959 - Block Grants for Prevention and Treatment of Substance Abuse

Federal Agency: U.S. Department of Health and Human Services

Pass-Through Entity: Not Applicable

Compliance Area: Subrecipient Monitoring

Amount of Questioned Costs: None

For the last two (2) years, we have tested for timeliness of the progress reports completed by Regional Prevention Centers (RPCs). In both years, we have found that timeliness was not being achieved.

In SFY 01, we found that eight (8) out of 13 reporting RPCs did not issue reports in a timely manner.

In FY 00 the Division of Substance Abuse made a transition from manual progress reports to electronic reporting. This electronic reporting required activity to be reported on a timely basis. When this change took effect, only five (5) of the 14 Community Mental Health Care Centers (CMHC) submitted activity reports in a timely manner. The APA issued an audit finding pertaining to this matter.

In response to the comment for FY00 the Management Response and Corrective Action Plan of CHS stated:

“The RPC and Champions Reporting Instructions included in all FY 01 CMHC contracts communicated the following performance expectation: Timeliness: 95% of all activities will be entered into the Prevention Data Set (PDS) by the end of the month following their completion.”

“If a center fails to provide any data for two consecutive months, a notice will be sent to the CMHC Executive Director requesting an investigation of the causes of the problem and giving a deadline for corrective action. Payments will be held for non-compliance.”

A member of the Department of Mental Health and Mental Retardation informed us that the enforcement of these rules would not actually take place until FY 02.

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SECTION 3 – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-CHS-11: The Division Of Substance Abuse Progress Reports For Subrecipient Monitoring Should Be Submitted In A Timely Manner (Continued)

Without timely reports, appropriate program staff is hindered from monitoring contract compliance and progress made toward meeting the goals and objectives outlined in the annual plan and budget. It also skews performance measures periodically calculated by program staff and hinders on-site reviews. Priority areas and evaluations of prevention performance measures cannot be identified to investigate during an on-site visit.

OMB Circular A-133, Section 400, Paragraph (d)(3) requires that states “monitor the activities of subrecipients to ensure that Federal awards are used for authorized purposes in compliance with laws, regulations, and the provisions of contracts or grant agreements and that performance goals are achieved.” One way that the Substance Abuse staff monitors compliance is through subrecipient reporting of progress and a review of these progress reports by program personnel. This off-site monitoring provides basis for on-site monitoring of the SAPT Block Grant Subrecipients.

Recommendation

We recommend that the Division of Substance Abuse enforce all policies and procedures when dealing with progress reports. These reports should be provided timely.

Management’s Response and Corrective Action Plan

In response to the FY00 audit findings, the Division developed specific policies and procedures for monitoring of timeliness (that would actually be effective for state fiscal year 02). By that time, FY01 was already over. Monitoring conducted during FY01 took the same approach as FY00. The Division was deliberately lenient in taking action against Centers for untimeliness due to several reasons: In the past, Centers have submitted the data in paper format and it takes time to work out the problems relating to electronic data submission. The data system was still relatively new and RPC staff still needed significant training and technical assistance and it was also helpful in building positive relationships with Centers regarding data issues.

Please note: The policy cited regarding the holding of payments does not refer to untimely reports but rather to Centers that failed to submit any data report. This situation did not occur in state fiscal year 01.

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SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-CHS-11: The Division Of Substance Abuse Progress Reports For Subrecipient Monitoring Should Be Submitted In A Timely Manner (Continued)

Management's Response and Corrective Action Plan (Continued)

For use in the remainder of FY 02 and FY 03, the Division will be reviewing and modifying its current policies and procedures for monitoring timeliness. There is some concern that current policies may be more stringent than those applied by other Divisions in the Department and that they may be more labor-intensive than is feasible given the staff resources available for monitoring. The Division will explore the policies and procedures applied throughout the Department with regard to monitoring timeliness, and make policy adjustments as deemed reasonable.

FINDING 01-CHS-12: The Cabinet For Health Services Should Have A System In Place To Identify Suspended Or Debarred Vendors

State Agency: Cabinet for Health Services

Federal Program: All Federal Assistance Programs

Federal Agencies: U.S Department of Agriculture,

U.S. Department of Justice,

U.S. Department of Labor,

U.S. Environmental Protection Agency,

U.S. Department of Energy,

U.S. Federal Emergency Management Agency,

U.S. Department of Education,

U.S. Department of Health and Human Services, and

U.S. Corporation for National and Community Services

Pass-Through Entity: Not Applicable

Compliance Area: Procurement and Suspension and Debarment

Amount of Questioned Costs: None

CHS does not have a system in place to identify suspended or debarred vendors, or to prevent them from doing business with state administered federal programs. This has been a prior year audit comment for CHS. However, last year FAC issued a draft policy statement to all State agencies to obtain a certification from successful vendors that they are not debarred from doing business with the Federal government prior to award of any contract. CHS has always obtained certification from its subrecipients that they are not suspended or debarred before an award is granted. However, CHS has been deficient in ensuring that procurement contracts of \$100,000 or more are not issued to vendors who are suspended or debarred.

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SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-CHS-12: The Cabinet For Health Services Should Have A System In Place To Identify Suspended Or Debarred Vendors. (Continued)

The APA tested all activity with expenditures greater than \$100,000. The results of our tests noted none of these vendors were suspended or debarred. However, CHS has a lack of controls in place to verify whether vendors or potential vendors have been suspended or debarred from transacting business with State administered federal programs, could result in CHS conducting business with vendors on the federal procurement exclusion list.

Federal Executive Order 12549 Section 5 requires that the Federal government compile a list of debarred and suspended vendors. The Common Rule prohibits agencies receiving Federal funds from using these vendors. In addition, OMB Circular A-133 Compliance Supplement Part 3, Section I requires the agency to ensure that contractors receiving more than \$100,000 and all subrecipients must certify to the agency that the organization is not suspended or debarred.

Recommendation

We recommend CHS implement the policy statement drafted by FAC when it is finalized concerning Federal procurements of \$100,000 or more.

Management's Response and Corrective Action Plan

The Cabinet for Health Services has worked very diligently with the Finance and Administration Cabinet (FAC) in the development of the debarment policy that is forthcoming. The Cabinet for Health services cannot implement the proposed Debarment Policy until it is finalized by FAC. Therefore, we will take the appropriate action to implement the policy upon its finalization.

**CABINET FOR HEALTH SERVICES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Other Matters Relating to Internal Control and Compliance:

FINDING 01-CHS-13: All Relevant Data Should Be Entered Into The Managed Care Program's Complaint/Grievance Call Log System In Order To Make Proper Determinations On How To Resolve A Complaint Or Grievance.

State Agency: Cabinet for Health Services

Federal Program: CFDA: 93.778 - Medical Assistance Program

Federal Agency: U.S. Department of Health and Human Services

Pass-Through Entity: Not Applicable

Compliance Area: Special Tests and Provisions

Amount of Questioned Costs: None

For three (3) years, we have performed testing of internal controls and compliance of the Managed Care Program's Complaint/Grievance Call Log System. In all cases, we found cases that fields on the data entry screen were not being entered.

During the testing of internal controls and compliance of the Managed Care Program's Complaint/Grievance Call Log System, we found that six (6) out of the 73 calls we selected for testing did not contain the social security number of the member phoning in.

In response to the comment for FY 00, the Management's Response and Corrective Action Plan of CHS stated the following:

"It is our goal that our revised logging system be accountable and efficient. We are currently testing the revised system and training staff on input processes. Many of the fields, "log date" included, will be mandatory fields. It is our goal to roll out this system department wide in order to ensure that all DMS staff have relevant data to make informed decisions about our members quality of care."

In our audit fieldwork for FY 01, we identified this is not the case and fields are still being left blank.

The Complaint/Grievance system cannot be used to its full potential by agency personnel unless all data is entered into the system when a call comes into the agency.

**CABINET FOR HEALTH SERVICES
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001
(CONTINUED)**

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING 01-CHS-13: All Relevant Data Should Be Entered Into The Managed Care Program's Complaint/Grievance Call Log System In Order To Make Proper Determinations On How To Resolve A Complaint Or Grievance (Continued)

A government entity needs an internal control structure which provides controls to ensure compliance with laws and regulations, safeguards its assets, checks the accuracy and reliability of its accounting data, and promotes operational efficiency. A good internal control structure is essential for the achievement of full accountability, which is a primary issue in today's government.

Recommendation

We recommend that agency data be entered into all fields of the complaint/grievance call log system. This will ensure agency personnel have all relevant data to make determinations on how to resolve a complaint/grievance.

Management's Response and Corrective Action Plan

The Department for Medicaid Services is in the process of moving to a new technology by going to a client server environment that will be used to develop and implement the Health Insurance Portability and Accountability Act (HIPPA) requirements. The QCSI-based(QCSI is Quality Care Solutions, Inc., which is a health care software vendor. See <http://www.qcsi.com>) solution has features the current Medicaid Management Information System (MMIS) does not have (e.g., an integrated call tracking feature). Each call will be logged based on time of call, user ID (person entering information into the system) and will be linked to the provider number (if the provider is enrolled into the Medicaid program) and/or to the member's Medical Assistance Identification (MAID) number. If the caller is provider/member not enrolled in the Medicaid program the call will be logged by name.

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SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

**CABINET FOR HEALTH SERVICES
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2001**

Fiscal Year	Finding Number	Finding	CFDA Number	Questioned Costs	Comments
<u>Reportable Conditions</u>					
<i>(1) Audit findings that have been fully corrected:</i>					
FY 00	00-CHS-4	The Division Of Substance Abuse Should Conduct Peer Reviews As Required By Federal Regulations	93.959	\$ 0	Resolved during FY 01.
FY 00	00-CHS-7	The Cabinet For Health Services Should Improve Controls Over Providers	93.778	0	Resolved during FY 01.
FY 00	00-CHS-8	The Department For Medicaid Services Should Comply With The Interagency Agreement With The Office Of Inspector General	93.778	0	Resolved during FY 01.
FY 99	99-CHS/CDP-27	Custom Data Processing Inc. Should Require Formal Requests For All Program Changes	N/A	0	Resolved during FY 01.
FY 98	98-CHS/CDP-1	Custom Data Processing, Inc. Should Improve Logical Access Security Procedures For The Cabinet For Health Services System Applications	N/A	0	Resolved during FY 01.
<i>(2) Audit findings not corrected or partially corrected:</i>					
FY 00	00-CHS-5	The Department For Medicaid Services Should Improve Claims Processing, Including The Dispute-Resolution Process With Drug Rebate Manufacturers	93.778	0	Drug rebate resolution process still needs improvement. See 01-CHS-9.
FY 00	00-CHS-6	The Division Of Substance Abuse Should Establish Procedures To Monitor Progress Reports	93.959	0	Improvements needed in timely reporting progress of federal program. See 01-CHS-11.

**CABINET FOR HEALTH SERVICES
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2001**

Fiscal Year	Finding Number	Finding	CFDA Number	Questioned Costs	Comments
<u>Reportable Conditions (Continued)</u>					
<i>(2) Audit findings not corrected or partially corrected (Continued):</i>					
FY 00	00-CHS-9	The Cabinet For Health Services Should Develop Procedures To Ensure Vendors Providing Services To Federal Programs Are Not Debarred Or Suspended By The Federal Government	ALL	\$ 0	Plans in place to implement in FY 03 upon FAC policy approval. See 01-CHS-12.
FY 99	99-CHS-7	The Department For Medicaid Services Should Improve The Controls Over Drug Rebate Billings, Collections, And Recording	N/A	0	The unresolved issues of this finding were made part of 00-CHS-5.
FY 97	97-CHS-47	The Finance And Administration Cabinet And The Cabinet For Health Services Should Develop Procedures To Ensure Vendors Providing Services To Federal Programs Are Not Debarred Or Suspended By The Federal Government	N/A	0	The agency will implement the policy set forth by FAC upon final approval. See 00-CHS-9.
FY 97	97-CHS-49	The Department For Public Health Should Develop A Complete Information System Security Policy	N/A	0	There was no formal system access request policy in place. No violation or attempted unauthorized system access reports were received from CDP for review.
<i>(3) Corrective action taken is significantly different from corrective action previously reported:</i>					
There were no findings for this section.					
<i>(4) Audit finding is no longer valid or does not warrant further action:</i>					
FY 96	N/A	The Department For Medicaid Services Should Improve Internal Controls Relating To The Alternative Intermediate Care/Mental Retardation Waiver	N/A	120,760	The agency implemented the corrective action plan. The questioned cost has not been resolved. However, the amount of questioned cost is immaterial to the Medicaid program and is not being pursued by the federal government.

**CABINET FOR HEALTH SERVICES
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2001**

Fiscal Year	Finding Number	Finding	CFDA Number	Questioned Costs	Comments
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Material Weaknesses/Noncompliances

(1) Audit findings that have been fully corrected:

There were no findings for this section.

(2) Audit findings not corrected or partially corrected:

There were no findings for this section.

(3) Corrective action taken is significantly different from corrective action previously reported:

There were no findings for this section.

(4) Audit finding is no longer valid or does not warrant further action:

There were no findings for this section.

**CABINET FOR HEALTH SERVICES
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2001**

Fiscal Year	Finding Number	Finding	CFDA Number	Questioned Costs	Comments
<u>Other Matters</u>					
<i>(1) Audit findings that have been fully corrected:</i>					
FY 00	00-CHS-1	The Cabinet For Health Services Should Improve Control Procedures Over The Medicaid Assistance Program		\$ 0	Resolved during FY 01.
FY 00	00-CHS-2	The Cabinet For Health Services Should Improve Controls Over The Review/Monitoring Process		0	Resolved during FY 01.
FY 00	00-CHS-11	The Department For Medicaid Services Should Improve Controls Over Nursing Facilities To Comply With Federal Regulations	93.778	0	Resolved during FY 01.
FY 00	00-CHS-12	The Department For Medicaid Services Should Improve Controls Over In-State Hospitals To Comply With Federal Regulations	93.778	0	Resolved during FY 01.
FY 00	00-CHS-13	The Cabinet For Health Services Should Strengthen Controls In Preparing The Schedule Of Expenditures Of Federal Awards	93.778	0	Resolved during FY 01.
FY 00	00-CHS-14	The Department Of Public Health Should Strengthen Controls Over The Visual Edit Checks Of Food Instruments	93.778	0	Resolved during FY 01.
FY 99	99-CHS-5	The Cabinet For Health Services Should Improve Controls Over Providers	93.778	0	Resolved during FY 01.
FY 99	99-CHS-9	The Department For Medicaid Services Should Comply With The Interagency Agreement With The Office Of Inspector General	93.778	0	Resolved during FY 01.
FY 99	99-CHS-10	Internal Control Over In-State Hospitals Should Be Strengthened To Insure Compliance With Regulations	N/A	0	Resolved during FY 01.

**CABINET FOR HEALTH SERVICES
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2001**

Fiscal Year	Finding Number	Finding	CFDA Number	Questioned Costs	Comments
<u>Other Matters</u> (Continued)					
<i>(1) Audit findings that have been fully corrected (Continued):</i>					
FY 98	98-CHS-10	The Department For Medicaid Services Should Improve Controls Over Nursing Facilities To Comply With Regulations	93.778	\$ 0	Resolved during FY 01.
<i>(2) Audit findings not corrected or partially corrected:</i>					
FY 00	00-CHS-3	The Cabinet For Health Services Should Strengthen Controls Over Cash Receipts		0	These were upgraded to reportable in FY 01. See 01-CHS-3 and 01-CHS-4.
FY 00	00-CHS-10	The Department For Medicaid Services Should Strengthen Controls Over Supplementary Medical Insurance Bills	93.778	0	Similar comment for FY 01. This comment was upgraded to reportable in FY 01. See 01-CHS-10.
FY 99	99-CHS-11	Internal Control Over The Managed Care Program Should Be Improved	93.778	0	The agency planned to implement the Medicaid Quality Tracking System in January 2001. A similar comment was issued in FY 01. See 01-CHS-13.
FY 99	99-CHS-12	The Department For Medicaid Services Should Strengthen Controls Over Supplementary Medical Insurance Bills	93.778	0	Similar comment for FY 01. This comment was upgraded to reportable in FY 01. See 00-CHS-10.

(3) Corrective action taken is significantly different from corrective action previously reported:

There were no findings for this section.

(4) Audit finding is no longer valid or does not warrant further action:

There were no findings for this section.